

Office of Chief Counsel
Internal Revenue Service
Memorandum

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to:
General Attorney

from: Norma C. Rotunno
Senior Technician Reviewer, Branch 2
(Income Tax & Accounting)

subject: Timing of a Theft Loss Deduction under Revenue Procedure 2011-58

This Chief Counsel Advice responds to your request for assistance dated June 22, 2012. This advice may not be used or cited as precedent.

LEGEND

A	=
B	=
New A	=
New B	=
taxpayer	=
State C	=
State C	=
Agency	
d	=
e	=
p	=
q	=
LF	=
Fact G	=
Fact H	=
Fact I	=

Fact J =

Date R =

Date S =

Date T =

Date U =

Date V =

Month W =

Date X =

Date Y =

Year 1 =

Year 2 =

Year 3 =

Year 5 =

ISSUE

Based on the facts described below, whether Year 2 or Year 3 is the proper discovery year under Rev. Proc. 2009-20, as modified by Rev. Proc. 2011-58, for taxpayer's theft loss claim.

CONCLUSION

Based on the facts described below, Year 2 is the proper discovery year for taxpayer's theft loss claim.

FACTS

A was registered with State C Agency to _____ for p in State C. B was _____ registered with the _____. A, through B, raised money from approximately d number of investors for the purpose of _____.

The Taxpayer is a Tier 2 entity that has ownership interests in several Tier 1 entities and has approximately e number of partners.

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On or about Date Y of Year 5, the taxpayer filed Form 8082, checking the box that such form constituted an Administrative Adjustment Request ("AAR"), as described in I.R.C. § 6227. The taxpayer filed the AAR with respect to its Form 1065, *U.S. Return of Partnership Income*, for its Year 2 tax return. This AAR contained three items. The first

¹ Some of the facts in this paragraph are from statements made by the taxpayer's representatives. You may want to confirm these facts by further examination.

reflected a change from long-term capital loss, reflected on a Form K-1 passed-through from a Tier 1 entity, to a theft loss deduction. The second reflected a theft loss and reduction of basis on the ownership interest in a Tier 1 entity. The third reflected a decrease in partner transfers of capital based on taxpayer records.

You asked for advice regarding whether Year 2 or Year 3 is the proper discovery year under Revenue Procedure 2011-58 for the taxpayer's theft loss claim relating to investments made through A and B.

LAW AND ANALYSIS

Section 165(a) of the Internal Revenue Code ("Code") allows a deduction for losses sustained during the taxable year and not compensated by insurance or otherwise. A loss from criminal fraud or embezzlement in a transaction entered into for profit is a theft loss under section 165(c)(2). See Rev. Rul. 2009-9, 2009-14 I.R.B. 735.

Revenue Procedure 2009-20

The Service and the Treasury Department issued Revenue Procedure 2009-20, 2009-14 I.R.B. 749, which provides an optional safe harbor for taxpayers who experience losses in certain criminally fraudulent investment arrangements, or so-called "Ponzi" schemes. The procedure provides investors with uniform and simplified procedures for determining the amount of a theft loss deduction.

Rev. Proc. 2009-20 allows a theft loss deduction to a "qualified investor" of a "qualified loss." See section 5 of Rev. Proc. 2009-20. The procedure defines a qualified loss as a loss resulting from a "specified fraudulent arrangement" in which, as a result of the conduct that caused the loss, the lead figure (or lead figures) of the scheme is criminally charged under state or federal law with the commission of fraud, embezzlement, or a similar crime that, if proven, would meet the definition of theft for purposes of section 165.² Section 4.02 of Rev. Proc. 2009-20. The procedure provides that a qualified investor may deduct the theft loss in the discovery year, defined as the year in which the criminal charge is filed. Sections 4.04 and 5.01(2) of Rev. Proc. 2009-20.

Revenue Procedure 2011-58

The Service recognized that the deaths of lead figures in certain Ponzi schemes prevented government authorities from charging them with criminal theft. In these cases, qualified investors would have been unable to meet the definition of a qualified loss in Rev. Proc. 2009-20 solely due to the death of the lead figure. Therefore, the Service and Treasury issued Rev. Proc. 2011-58, 2011-50 I.R.B. 849, to address those cases.

² There are additional requirements in section 4 of the revenue procedure with respect to the type of criminal charge, whether an admission by the lead figure is alleged, and the appointment of a receiver or trustee with respect to the fraudulent arrangement or assets of the arrangement being frozen.

Rev. Proc. 2011-58 modified the definition of qualified loss in Rev. Proc. 2009-20 to add that the lead figure or an associated entity involved in the specified fraudulent arrangement was the subject of one or more civil complaints or similar documents (such as a notice or order instituting administrative proceedings or other document the Internal Revenue Service designates) filed by a state or federal governmental entity with a court or in an administrative agency enforcement proceeding, and all of the following requirements are satisfied:

- (a) The civil complaint or similar documents together allege facts that comprise substantially all of the elements of a specified fraudulent arrangement conducted by the lead figure;
- (b) The death of the lead figure precludes a criminal charge by indictment, information or criminal complaint against that lead figure; and
- (c) A receiver or trustee was appointed with respect to the arrangement or assets of the arrangement were frozen. Section 4.01 of Rev. Proc. 2011-58.

In addition, the procedure modified the definition of discovery year in Rev. Proc. 2009-20 to include the later of either the year in which the civil complaint or similar document which alleges facts that comprise substantially all the elements of a specified fraudulent arrangement is filed, or the year in which the lead figure dies. Section 4.02 of Rev. Proc. 2011-58.

In the present case, the latter two requirements of Revenue Procedure 2011-58 described above are clearly satisfied. LF, the lead figure, died in Year 1 without being criminally charged for actions with respect to A and B. In addition,

With respect to the first requirement above,

None of these documents are civil complaints filed with a court. Therefore, in order to satisfy the first requirement above, these documents must constitute similar documents that together allege facts that comprise substantially all of the elements of a specified fraudulent arrangement conducted by the lead figure, and must be filed by a governmental entity in an administrative agency enforcement proceeding.

are similar documents filed in an administrative agency enforcement proceeding.

³ Therefore, the filing of these documents does not, alone,

³ It is our understanding that the taxpayer does not dispute this point.

control the proper year of discovery under the safe harbor procedures. These documents do, however, allege some facts relevant to the elements of a specified fraudulent arrangement, as discussed above.

are similar documents filed
in an administrative agency enforcement proceeding.
allege facts that comprise substantially all of the elements of
a specified fraudulent arrangement conducted by LF.

in Year 2, thereby putting all investors on notice regarding the facts of the
specified fraudulent arrangement conducted by LF.

filed in Year 2 are
documents similar to a civil complaint and, together, allege facts that comprise
substantially all of the elements of a specified fraudulent arrangement conducted by the
lead figure. Since the
were filed in administrative agency enforcement
proceedings in Year 2, after the death of the lead figure in Year 1, the discovery year,
as defined in Rev. Proc. 2011-58, is Year 2.

This writing may contain privileged information. Any unauthorized disclosure of this
writing may undermine our ability to protect the privileged information. If disclosure is
determined to be necessary, please contact this office for our views.

Please call (202) 622-7900 if you have any further questions.

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